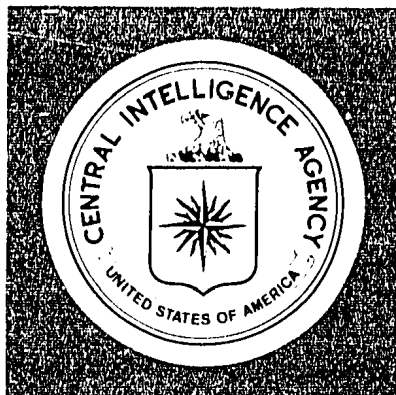


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Intelligence Report

The Economic Situation in South Vietnam, December 1974

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January 1975

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The Economic Situation
In South Vietnam
December 1974

SUMMARY

The economic event receiving the most attention in South Vietnam during December was the announcement by Deputy Prime Minister for Economic Development Hao of his strategies for stabilization and growth. Bland on the surface, they generated hectic debate within the cabinet and did nothing to resolve uncertainty among currency and gold speculators. For the first time since December 1973, the piaster -- whose official rate is changed fairly regularly -- was selling at a sizable discount.

Commodity markets were essentially stable, and the year ended with a cumulative inflation rate of 40.5%, about half of which had taken place in the first quarter.

Other topics reviewed in this report include

- a preliminary aid agreement for 1975 signed with France,
- the effect of inflation-recession and recent policy changes on GVN tax collections,
- the renewal of charcoal exports,
- government attempts to increase domestic sugar production, and
- a review of South Vietnam's iron and steel industry.

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Note: Comments and queries regarding this report are welcomed. They may be directed to [redacted] of the Office of Economic Research, [redacted]

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DISCUSSION

Economic Policies Announced

1. The newly appointed Deputy Minister for Economic Development, Nguyen Van Hao, announced his basic economic strategies at a press conference on 14 December. The announcement was delayed from 10 December, reportedly because of Cabinet opposition to a number of the proposals.

2. The program, entitled a "New Economic Era," envisions austerity for both individuals and the government in order to live within the reduced foreign exchange receipts available to the nation. Although there were few specific policy measures mentioned at the announcement, the broad outlines of the program are

- *public sector policies:* fiscal restraint centering on reduced government spending; more efficient use of resources through reduction of administrative bottlenecks;
- *private sector policies:* lower interest rates to encourage credit expansion; increased responsiveness to investment proposals; stabilization of commodity prices by promoting increased production; and
- *foreign sector policies:* more efficient import controls and expanded credit to the export sector to help reduce the huge trade deficit.

3. Hao's proposals revealed little that was new and generally reflect widely held views on the key problems facing the Vietnamese economy. Considering the blandness of his "package," the related activity in financial markets (see below) can best be explained as apprehension that he is still thinking in terms of a sharp devaluation of the piaster.

Similar speculation can be expected to attend other statements and actions by Hao because of the inconsistency he has shown in the past on various economic issues. Moreover, there will continue to be doubts among older politicians concerning his capability to discharge his sharply increased responsibilities. At the same time, some Vietnamese question whether additional austerity measures would do more than contribute to further unemployment or impede longer term growth. Some or all of these factors were probably instrumental in cabinet infighting that led to a four-day postponement of the Hao speech.

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Market Conditions¹

4. Uncertainty over the intentions of the government's new economic team and -- to a lesser extent -- seasonal influences had a marked effect on financial markets this month. Notwithstanding a modest devaluation on 10 December from 670 piasters to 685 piasters to the dollar,² black market rates of about 800 piasters per dollar during most of December -- up from 682 as recently as the end of November -- clearly suggest that speculators foresee a major devaluation. Saigon markets have also put a premium on holding gold. Prices have moved steadily upward since early October, and at \$220 an ounce on 31 December were about \$30 an ounce above Hong Kong gold prices. Christmas and Tet-related demand in illegal markets for gold and banned luxury imports also helped to push gold and currency prices upward.

5. Saigon consumer prices rose slightly during the second half of December from a level that had remained fairly constant since August. Rice prices continued to move upward, increasing 6% for the month; poultry and meat prices also rose 3%-7%, mostly because of holiday demand.

6. For the year, Saigon consumer prices rose 40.5%, with nine-tenths of this occurring during January-August. Prices jumped 20% in January-March after administered petroleum price increases of 65%-140% in January worked their way through the rest of the economy. Rising food prices have accounted for most of the remaining increase.

French Aid Agreement Signed

7. The GVN signed a new aid agreement with the French government on 9 December for 130 million francs (nearly \$30 million) in grants and loans for 1975. This amount is to be divided between \$16 million for commercial imports, \$600,000 for feasibility studies, and \$12 million for development projects.³

8. Although the \$16 million in import assistance for 1975 -- like the \$10 million from a similar program for 1974 -- will finance less than 2% of South

1. Charts showing major economic indicators follow the text.

2. This was the tenth devaluation in 1974, and more than two months had elapsed since the last such move.

3. France also signed an aid agreement with North Vietnam on 29 November 1974 for approximately the same amount at similar terms.

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Vietnam's import requirements, the commitment increase has been enthusiastically received. Up to the end of September, credit openings on the earlier \$10 million import program had amounted to some \$9 million. Less than \$2 million had appeared in import arrivals through mid-November, but this is not unusual in light of normal administrative, marketing, and transport delays.

GVN Tax Collections

9. Although national government tax receipts were up for 1974 as a whole, they declined during much of the year. For the first nine months, receipts were 230.6 billion piasters, compared with 150.5 billion in the same period in 1973.⁴ By the third quarter, however, the government take was down to 69.4 billion piasters from 86.5 billion in the first quarter.

10. Most of the year-to-year increase in tax collections came from indirect taxes, which account for more than 50% of total revenues. The value-added tax (VAT), introduced in July 1973, brought in an estimated 74 billion piasters in 1974, compared with only 28 billion piasters in 1973. The special consumption tax (SCT), instituted in 1972 to replace then-existing excise and consumer taxes, provided 125 billion piasters in 1974, up from 69 billion in 1973. The biggest factor underlying both of these increases was sharply higher import and domestic prices for petroleum products. Direct taxes, accounting for about 10% of GVN revenues, also increased in 1974. Nearly all of this gain came from corporate income tax collections, which rose 75% from 1973 with more energetic collection efforts and somewhat higher profit margins. Personal tax returns showed no growth, probably reflecting both further real revenue losses in urban areas and decreasing compliance.

11. The decline in quarterly revenues after early 1974 stemmed mainly from the reduction of most perequation taxes⁵ beginning in May. Perequation taxes on POL were eliminated because piaster devaluations and global price increases had already erased the margin between high government-set retail prices and import costs. Moreover, a ban on sugar imports eliminated them as a tax base, and perequation taxes on beer, liquor, cigarettes, and matches were reduced to mitigate the high cost of living. Customs revenues also appear to have diminished as import levels continued to decline.

4. Using the retail price index, this represents a 3%-4% decline in real terms.

5. These taxes were initially intended to equalize import prices from different suppliers and to reduce import competitiveness against high-cost domestic substitutes. The original intent having been obscured over time, perequation taxes had become an important source of revenue.

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12. Although data are not yet available for the final quarter of 1974, the key series affecting tax collections indicate that revenues will probably continue to slip. Inflation has abated and no longer provides an assured expansion of the nominal base for indirect taxes. Moreover, the sharp decreases in import licensing will be reflected in a shrinking number of arrivals, the urban recession continues, and real incomes remain depressed. Seasonal factors such as the incoming harvest and holiday buying may account for revenue increases in selected areas, but these are unlikely to be sufficient to reverse the downward trend.

Charcoal Production and Exports Revive

13. Spurred by reductions of petroleum imports and rising fuel prices, charcoal production in South Vietnam has expanded once again, and small quantities have been exported for the first time since the 1950s. Output is currently at the highest level since the early 1960s; more than 13,000 metric tons was produced in the first eight months of 1974. Although exports last year were small, their potential is significant. During the late 1950s, South Vietnam sold as much as 60,000 tons annually, worth about \$5 million in current prices. Considering domestic security conditions, this level probably will not be regained soon, but charcoal exports conceivably could reach the \$1 million mark in a few years time in the prevailing buoyant world market for inferior fuels.

14. The Communists, who control a large part of the nation's forestry resources, have had an important role in both the earlier decline and current recovery. Charcoal production dropped precipitously in the mid-1960s owing to insecurity in forest areas as well as the use of aid-financed petroleum fuels. Although its resurgence has directly helped the GVN conserve foreign exchange, the Communists probably are also securing increased revenues from it.

Sugar Production

15. Following a long period of heavy reliance on imports to meet domestic sugar demand, rising prices and GVN initiatives have spurred Vietnamese production. As the government allowed the administered price of sugar to rise from 25 cents a kilogram to some 90 cents during 1972-73, annual production of cane expanded from the 300,000-350,000 tons characteristic of the late 1960s and early 1970s to more than 500,000 tons in 1973 and an estimated 750,000 tons in 1974.⁶ The government has also been lifting its security related restrictions

6. In general, sugarcane reduces to refined sugar at a rate of about 10 to 1.

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on sugar growing in many areas and increasing agricultural credit for sugar development. As further stimulants, sugar imports were banned in July 1974 and the government announced that its stocks would be sold only to industrial users until depleted.

16. Although South Vietnam's immediate needs are being met, current production is still well below the amounts required should urban real incomes or industrial output revive. Although detailed, reliable data on consumption are unavailable, sugar consumption levels in earlier periods and other countries suggest that South Vietnam uses the equivalent of about 2 million tons of cane a year in normal times.⁷ This year, it appears that consumption has been partly sustained by stock drawdowns. Stockpiles accumulated from unusually large arrivals in 1973 (see the table) have cushioned the impact of the import ban, and government stocks are expected to fill the needs of industrial users throughout most of 1975.

Sugar Imports

	Thousand Metric Tons		
	Total	Raw Sugar	Refined Sugar
1970	102	102
1971	229	163	66
1972	166	159	7
1973	362	362
1974 (Jan-Sep)	10	10

17. Even assuming no sharp changes in security, there are still clear limits over the next few years to how much domestic sugar expansion will cover Vietnamese requirements. Economic recovery from the recession now plaguing urban areas in general would probably result in an expansion of sugar demand in the food processing and beverages industries that could not be met in the short run from further domestic output. Over the longer term, expanding domestic sugar production and boosting low cane yields will require substantial capital investment in irrigation facilities and increased imports of fuel, fertilizer, and machinery.

South Vietnam's Iron and Steel Industry

18. Although South Vietnam continues to import most of the steel products it uses, a small steel industry, based largely on the use of war-related scrap, is

7. This is based on consumption data from the early 1960s adjusted for population growth, recent trends in South Vietnam's import and production levels, and comparative per capita consumption levels in other less developed countries in the region.

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now serving some domestic needs. Capable of smelting, casting, and rolling, this industry produces reinforcing bars, steel rods, and nails from facilities with a combined capacity of 60,000 tons (of which less than three-fourths is currently in use). The relatively new industry has an important part to play in conserving scarce foreign exchange, although this role is limited by its modest capacity, the supply of scrap, and the narrow range of its output.

19. All six of the nation's small mills are in the Saigon area. The largest and most important is *Vicasa* (Vietnam Casting and Rolling Mill), which accounts for about one-third of total capacity. This company has operated since 1969 and has its own powerplant, three furnaces, and a rolling mill. Its production of reinforcing bars has grown from 13,400 tons in 1971 to 16,500 tons in 1973, and it has supplied limited quantities to the export market. The five other firms have less-advanced equipment than *Vicasa*, although one -- *Sakynaco* -- is installing a rolling mill and the others envision rolling operations in reported expansion plans.

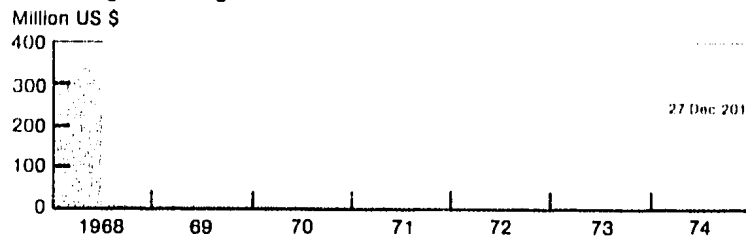
20. For the next few years, this line of industrial expansion can provide significant further foreign exchange savings, but can displace only some types of imported steel products. Several years ago, imports of the types of items now produced by the domestic steel industry amounted to somewhat more than 100,000 tons a year (worth more than \$40 million in 1974 prices). Many types of steel products, however, such as steel sheets, plates, sections, and pipe, cannot be produced in South Vietnam with the present small-scale technology. Import demand for these products in the early 1970s was about 125,000 tons (more than \$100 million in 1974 prices).

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South Vietnam: Economic Indicators

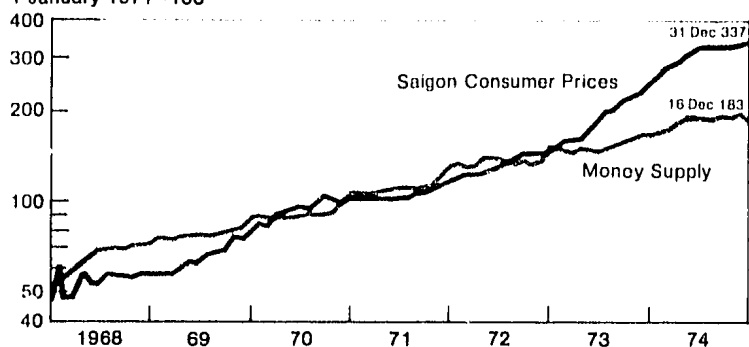
Unless otherwise indicated, data are as of the end of the month

Foreign Exchange Reserves



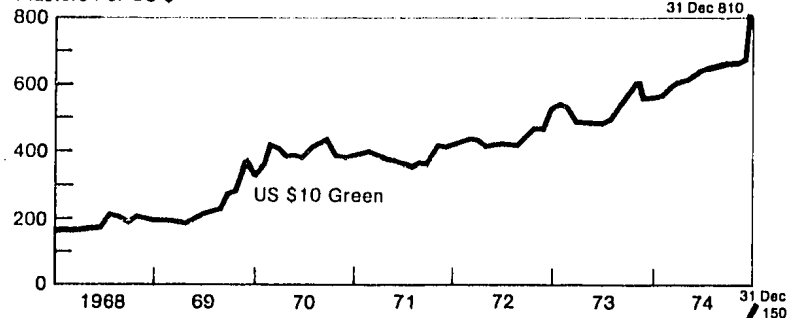
Indexes of Money Supply and Saigon Consumer Prices

1 January 1971 = 100



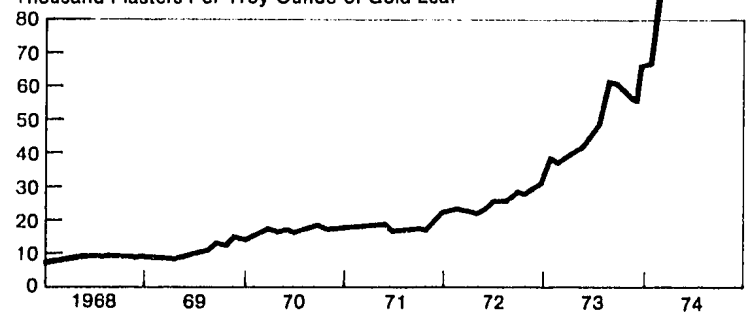
Free Market Currency Prices

Piasters Per US \$



Free Market Gold Prices

Thousand Piasters Per Troy Ounce of Gold Leaf



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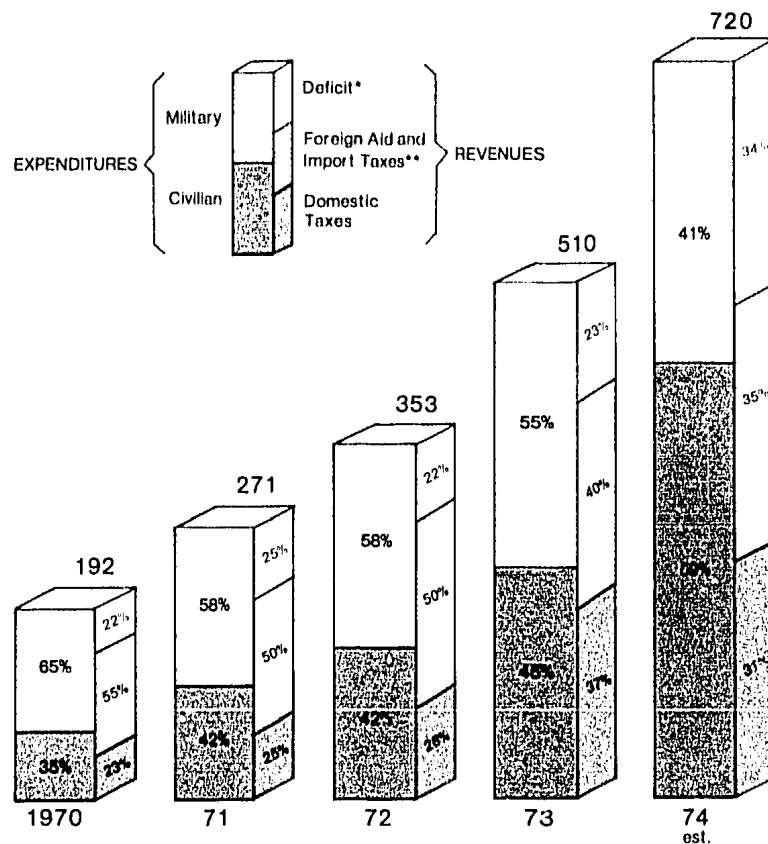
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South Vietnam: Government Budget

Billion Plasters



*Residual. Financed primarily by borrowing from the National Bank.

**Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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